

What Seinfeld Can Teach Us About LLC Liability

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In a classic episode of *Seinfeld*, Jerry arrives at a rental car counter to pick up the car he reserved, only to learn the agency has no car for him. His response has become a fixture of popular culture: “See, you know how to *take* the reservation, you just don’t know how to *hold* the reservation, and that’s really the most important part of the reservation, the holding. Anybody can just take them.”

The same principle applies to limited liability companies. Anybody can *form* an LLC. The filing takes minutes and costs very little. But respecting the LLC’s formalities by actually operating, contracting, and holding yourself out as the company, is really the most important part.

A recent decision from New York’s Appellate Division, Second Department, *710 E Elizabeth Ave, LLC v. Jhong Kim*, illustrates what happens when a business owner forms an LLC, but fails to use the entity properly. Defendant Jhong Kim owned real property through an LLC. He borrowed \$300,000 for construction on the property and failed to repay it. The lender sued him individually for the outstanding loan. Mr. Kim argued that because the property was owned by an LLC, he was not personally responsible for the loan. The Court held that because Mr. Kim never informed the lender that he was borrowing on behalf of the LLC, he was individually responsible for repayment of the loan. The Court explained what seems obvious: if the LLC is not disclosed to the lender, the member is not protected from the obligation.

Liability Protection Must Be Earned

Business owners routinely form special purpose LLCs to own a single property, complete a project, or close a particular deal, precisely so that the liabilities of that venture stay inside the entity. That protection is real, but it is not automatic. It depends on the members and managers carefully treating the LLC as a separate business in their dealings with the outside world.

710 E Elizabeth Ave shows the most direct way the shield fails: contracting in your own name rather than the company’s. But it is not the only way. Where members commingle personal and company funds, pay company obligations from personal accounts (or vice versa), undercapitalize the entity, or disregard the governance requirements of their own operating agreement, a creditor may ask a court to disregard the entity and impose personal liability.

Courts can pierce the veil where an entity is so dominated that it is merely an alter ego of its owners and adherence to the fiction of separateness would perpetrate a fraud or injustice. Each lapse in formality makes that argument more viable.

Steps for LLC Members and Managers to Consider

Before Signing a Contract

- Form the LLC, obtain its federal EIN, and open a dedicated bank account before the entity enters into any transaction.
- Adopt a written operating agreement, and confirm who has authority to bind the company and whether member or manager consent is required for the transaction.
- Make sure the contract, promissory note, or other document identifies the LLC, by its exact legal name, as the contracting party.
- Sign in a representative capacity, not simply as “Owner” or with your name alone.
- Tell the counterparty, in writing, that you are acting for the LLC. As the court made clear, the burden of proving disclosure falls on the person claiming the protection.
- Know what you are guaranteeing. If a lender requires a personal guaranty, that should be a deliberate, separately documented decision.

After Signing a Contract

- Receive all loan proceeds and pay all project expenses through the LLC’s own account. Do not commingle personal and company funds.
- Keep invoices, emails, letterhead, and correspondence in the LLC’s name, and have contractors and vendors bill the LLC.
- Document capital contributions and distributions, and paper any loans between members and the LLC.
- Hold any meetings and obtain any consents required by the operating agreement, and keep written records of significant decisions.
- Keep the LLC in good standing by filing annual reports and paying required fees.
- Maintain separate books and records, and keep a complete file of the executed transaction documents.

Takeaways

710 E Elizabeth Ave, LLC v. Jhong Kim is a costly reminder that an LLC protects only those who disclose it and use it properly. The time to protect yourself is before the contract is signed, not after a dispute arises. Anybody can just *form* an LLC. But is the respecting of the structure that is really the most important part.

If you have any questions about the above alert, please contact Michael Shortt or Jack Losinger of Saiber LLC’s business litigation practice group.